INVESTMENT COMPANY INSTITUTE®

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

ICI Global

35 New Broad Street, London EC2M 1NH, UK
+44 (0) 203 009 3100 www.iciglobal.org

July 5, 2013

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: *Draft Final Guidance regarding Compliance with Certain Swap Regulations (RIN 3038–AD85)*

Dear Ms. Jurgens:

The Investment Company Institute ("ICI")[1] and ICI Global[2] are writing to express our concern regarding the manner in which the Commodity Futures Trading Commission ("CFTC" or "Commission") is developing its guidance on the cross-border application of the swaps provisions ("cross-border guidance") and, in particular, the definition of "U.S. person" applicable to funds and other collective investment vehicles that we understand the Commission is considering as part of its final cross-border guidance. We understand that the Commission does not intend to extend its exemptive order granting market participants temporary conditional relief from certain provisions of the Commodity Exchange Act ("CEA").[3] We also understand the Commission may adopt final cross-border guidance prior to the July 12 expiration date of the Temporary Cross-Border Order that is even broader, in certain respects, than the cross-border guidance the Commission previously has proposed.[4]

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $15.3 trillion and serve over 90 million shareholders.

[2] ICI Global is the global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICI Global seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICI Global manage total assets in excess of US $1 trillion.

[3] *See Final Exemptive Order regarding Compliance with Certain Swap Regulations*, 78 FR 858 (Jan. 7, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-01-07/pdf/2012-31736.pdf ("Temporary Cross-Border Order").

[4] *See Further Proposed Guidance regarding Compliance with Certain Swap Regulations,* 78 FR 909 (Jan. 7, 2013), *available at* http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-31734a.pdf ("Further Proposed Guidance"); *Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act*, 77 FR 41214, *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-07-12/pdf/2012-16496.pdf (July 12, 2012) (together, "Proposed Guidance").

We urge the Commission to not adopt cross-border guidance in a hasty manner, but take the time necessary to develop thoughtful and workable guidance that reflects industry input, and that is coordinated with other domestic and international regulators. International regulators have urged the CFTC to work with them to find mutually agreeable solutions to the application of cross-border derivatives regulations, and not unilaterally impose its cross-border guidance.[5]

Developing a practical definition of U.S. person for non-U.S. funds is critical to the successful application of such guidance. As currently drafted, the definition would include, as U.S. persons, potentially all non-U.S. funds that are advised or sponsored by an asset manager located in the United States, including those non-U.S. funds that are similar to funds registered in the United States under the U.S. Investment Company Act of 1940 ("U.S. Investment Company Act") as investment companies. We believe this result would be inconsistent with the mandate under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that Title VII shall not apply to activities outside the United States unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States. In addition to the comments we have previously submitted on the Proposed Guidance,[6] we offer the following further comments.

U.S. Person Definition

ICI and ICI Global are concerned that the definition of U.S. person we understand that the CFTC currently is considering could significantly disadvantage non-U.S. publicly offered, substantively regulated funds ("non-U.S. retail funds")[7] that have only a nominal nexus to the United States. These

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[5] *See, e.g.,* Letter from Steven Maijoor and Jonathan Faull, European Commission, Directorate General Internal Market and Services, to Mr. Gary Gensler, Chairman, CFTC, dated May 28, 2013.

[6] *See* Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Melissa Jurgens, Secretary, CFTC, dated Feb. 6, 2013 ("February ICI Letter"); Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to David Stawick, Secretary, CFTC, dated Aug. 23, 2012 ("August ICI Letter," and together with the February ICI Letter, "Prior ICI Letters").

[7] For purposes of this letter, the term "non-U.S. retail fund" refers to any fund that is organized or formed outside the United States, is authorized for public sale in the country in which it is organized or formed, and is regulated as a public investment company under the laws of that country. Generally, non-U.S. retail funds are regulated to make them eligible for sale to the retail public, even if a particular fund may elect to limit its offering to institutional investors. Such funds, like U.S. registered investment companies, typically are subject to substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, investment restrictions (e.g., leverage, types of investments or "eligible assets," concentration limits and/or diversification standards). For example, in Canada, mutual funds are generally regulated as securities by Securities Acts in place in each province, and specifically regulated as funds in a series of detailed national instruments and their companion policies that apply across the country. Funds are primarily regulated by National Instrument (NI) 81-102 which includes portfolio investment rules, including limits on leverage and borrowing, as well as requirements on custodianship, sales, redemptions, net asset value calculation, fundamental changes and sales communications, among others. Detailed disclosure rules governing form and content of prospectuses, annual information forms and Funds Facts (analogous to the U.S. summary prospectus) are set out in NI 81-101. Other substantive rules

funds may engage in derivatives transactions globally, and may utilize the services of an asset manager located in the United States to manage the funds' assets. Non-U.S. retail funds are offered and sold in countries around the world (e.g., UCITS,[8] Canadian mutual funds, Japanese investment trusts etc.). Like U.S. registered funds, these non-U.S. retail funds are essential to helping people save and invest to meet their most important goals. The substantial advantages that these funds provide to investors are consistent across international borders. They include professional management, diversification, and reasonable cost, as well as the benefit of substantive government regulation and oversight that is similar in scope to that provided by the U.S. Investment Company Act.

We understand that the draft final cross-border guidance being reviewed by the Commission would capture non-U.S. retail funds within the definition of U.S. person in two ways:

1. Funds that have a majority of U.S. investors except for publicly-traded funds that are not offered to U.S. investors; and
2. Funds that have a principal place of business in the United States (which would look to where the sponsor/promoter and investment management activities are being conducted).

It appears that these tests would be applied to non-U.S. funds very broadly. If a non-U.S. fund is found to be a U.S. person, there would be no substituted compliance permitted for reporting, clearing, or trading requirements.

Modifications to these tests are necessary to avoid applying Title VII to those non-U.S. funds that have only a limited nexus to the United States. First, the majority U.S. person test is not workable for non-U.S. retail funds. As we discussed in the Prior ICI Letters, many non-U.S. retail funds, while publicly offered, are not publicly-traded in the secondary market and therefore would not be excluded by the proposed majority U.S. person test on this basis.[9]

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regulate areas such as sales practices (NI 81-105), continuous disclosure (NI 81-106) and independent review committees to consider conflict of interest matters (NI 81-107).

[8] UCITS, or "undertakings for collective investment in transferrable securities," are collective investment schemes established and authorized under a harmonized European Union ("EU") legal framework, currently EU Directive 2009/65/EC, as amended ("UCITS IV"), under which a UCITS established and authorized in one EU Member State ("Member State") can be sold cross border into other EU Member States without a requirement for an additional full registration. Detailed requirements applicable to UCITS include those related to disclosure and custody as well as investment restrictions and limitations. See UCITS IV (requirements regarding simplified disclosure (key investor information document) (Art. 78), annual and semi-annual reports (Art. 68), appointing a depositary bank as a custodian and its responsibilities (Art. 22), redemption (Art. 76), diversification and issuer concentration (Art. 52 and Art. 56), permitted assets, including limitations relating to derivatives and leverage (Art. 50 and Art. 52)).

[9] There is an important distinction between publicly-traded funds and publicly-offered funds: publicly-offered funds are those that are broadly available to retail investors; publicly-traded funds are simply a subset of publicly-offered funds that trade on exchanges or other secondary markets. Excluding from the U.S. person definition only publicly-traded funds would capture only a subset of non-U.S. regulated funds. We note that, by contrast, hedge funds are neither publicly offered nor

Further, ownership verification is difficult for many "publicly-offered" funds (and for "publicly-traded" funds) because of the manner in which many publicly-offered fund shares are sold and recorded on the fund books. These funds cannot verify (for purposes of determining majority ownership) whether fund shareholders are U.S. persons despite not offering their shares to U.S. persons. Investors in non-U.S. retail funds typically purchase shares through intermediaries (not directly from the fund), and these shares are registered and held in nominee/street name accounts by the recordkeeper.[10] When shares are held through these types of omnibus accounts, the fund manager/operator (and its administrator/recordkeeper) typically does not have information regarding the underlying investors who are the customers of the intermediary.[11] In fact, there may be multiple layers of omnibus intermediaries through which the ultimate investors may hold shares.[12] Moreover, certain jurisdictions may prohibit disclosure by intermediaries of beneficial owner information such as, for example, personal addresses that may constitute "personal data," under EU data protection laws. For these reasons, a fund manager/operator (and its administrator/recordkeeper) would not be able to verify whether a non-U.S. retail fund may nevertheless have U.S. persons as investors.

Second, the "principal place of business" test is not appropriate for funds because they generally are externally managed and have no employees or offices of their own. Instead, the fund contracts for services with a variety of providers, which may be located in multiple jurisdictions. We urge the CFTC not to base the "principal place of business" test on the location of fund's service providers (such as sponsors/promoters and investment managers).[13] Looking to the location of the activities, employees, or offices of the "sponsor" or "adviser" of a non-U.S. retail fund is not appropriate because the risk of a transaction remains with the non-U.S. fund and would not migrate to the United States with the use of the services of a U.S. adviser or U.S. sponsor. Each fund is a separate pool of securities with its own

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publicly traded and, unlike non-U.S. retail funds, are not subject to substantive government regulation and oversight similar in scope to that provided by the U.S. Investment Company Act.

[10] *See* OECD, *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles* (April 2010).

[11] For non-U.S. retail funds, beneficial owner positions are predominantly held in omnibus accounts on the books of the fund in the name of the financial intermediary (*e.g.,* a financial institution or insurance company), acting on behalf of its customers. An omnibus account includes the shares of multiple investors (sometimes numbering in the thousands) including both individual and institutional customers and represents the aggregate share balance of all the subaccounts for these investors. Omnibus accounts are a common way for funds to efficiently process purchases and redemptions of their shares, and are growing in use. In limited circumstances, non-U.S. retail funds may also have intermediary-controlled individual accounts in which the fund has no relationship or contact with the customer. These accounts are typically registered in the name of the intermediary for the benefit of a non-disclosed individual customer.

[12] An intermediary's omnibus account with the fund may include other omnibus accounts for which the intermediary provides services and keeps records. The fund manager/operator (and its administrator/recordkeeper) would not have transparency or information about the beneficial investors that are customers of intermediaries held in omnibus accounts.

[13] U.S. registered investment companies, for example, are incorporated in the United States and would be considered a U.S. person without the application of the principal place of business provision.

assets, liabilities, and shareholders, and the U.S. asset manager does not guarantee the fund's transactions. Merely having an adviser or sponsor located in the United States would not result in risks being brought onshore.

Consequences of Defining Non-U.S. Retail Funds with a Nominal Nexus to the United States as a "U.S. Person"

The definition of U.S. person would impose significant regulatory obligations on non-U.S. retail funds that have only a tangential nexus to the United States. These non-U.S. retail funds would have to comply with the swaps provisions of the CEA, which may overlap or conflict with the regulations of their home country. For example, if a UCITS fund is classified as a "U.S. person," solely because it has an investment manager located in the United States, then the fund's derivatives transactions will be subject to the Dodd-Frank Act requirements. The fund's derivatives transactions also would, however, be subject to regulation under the European Market Infrastructure Regulation ("EMIR"), resulting in potentially overlapping and conflicting regulatory obligations.[14]

This result is inconsistent with the Dodd-Frank Act mandate that Title VII will not apply to activities outside the United States unless those activities, in part, have a direct and significant connection with activities in, or effect on, commerce of the United States or when they contravene such rules as the CFTC may adopt to prevent evasion.[15] An over-broad definition of U.S. person also is unnecessary to achieve the CFTC's regulatory objectives. Transactions by a non-U.S. retail fund would not raise risks to the U.S. markets or U.S. investors, regardless of where portfolio decisions are made. A non-U.S. retail fund that hires a U.S. asset manager would not have any expectation of having its derivatives transactions with other non-U.S. counterparties subject to Title VII, nor would its investors expect to receive the protections of U.S. regulation. Non-U.S. counterparties of such a non-U.S. fund would not expect to be subject to Title VII requirements merely because their counterparty was managed by a U.S. asset manager.

U.S. asset managers to non-U.S. retail funds, however, would find themselves at a significant disadvantage to their non-U.S. counterparts, resulting in harm to U.S. business, and potentially driving such asset management business overseas. These non-U.S. funds would be subject to significant and potentially overlapping derivatives regulations as a result of having an asset manager that is located in the United States. To avoid unnecessary costs and burdens, these non-U.S. funds may terminate the U.S. asset manager and avoid hiring a U.S. asset manager in the future, because they may not want to be disadvantaged vis-à-vis other non-U.S. retail funds that do not have a U.S. asset manager. Furthermore, non-U.S. entities may seek to avoid engaging in transactions with non-U.S. retail funds that would be U.S. persons, as a non-U.S. entity engaging in derivatives transactions outside the United States with a U.S. person would be required to comply with certain requirements of the Dodd-Frank Act and CFTC

[14] *See* August ICI Letter, *supra* note 6, at 4-5.

[15] *See* Section 722(d) of the Dodd-Frank Act.

regulations. These disincentives would discourage a non-U.S. retail fund from selecting a U.S. asset manager, even if the U.S. asset manager may have the best expertise to manage the fund. Such a result would be harmful to the fund, its investors, and the U.S. asset management industry.

Alternative Definition for Funds

To address these concerns, we recommend that the Commission include in the final cross-border guidance an alternative definition for funds that specifies that a pool, fund or other collective investment vehicle will not be deemed a U.S. person if it is publicly-offered only to non-U.S. persons. Thus, non-U.S. retail funds would not be defined as U.S. persons, even if they have an asset manager or sponsor/promoter located in the United States. As noted above, certain non-U.S. retail funds may be eligible for sale to the retail public, even if a particular fund may elect to limit its offering to institutional investors.[16] We believe these non-U.S. retail funds also should not be deemed U.S. persons. We believe this alternative definition would include, as U.S. persons, those non-U.S. funds that have a direct and significant connection with the United States or U.S. investors, while excluding those non-U.S. funds that do not raise risks to U.S. investors or the U.S. markets. As discussed above, non-U.S. retail funds are substantively regulated under the laws of the jurisdiction in which they are organized or authorized for sale, and do not target the U.S. markets or U.S. investors.

As discussed in the Prior ICI Letters, focusing on how and to whom the fund's offer is made has two key advantages. First, if the "U.S. person" determination is made by how a commodity pool, pooled account, or collective investment vehicle conducts its offerings, the definition will be workable and systems are already in place to comply with the standard. This approach also would provide certainty to counterparties at the outset of a swap transaction regarding which laws would govern. Therefore, both counterparties would be able to plan for, and address, the consequences of the "U.S. person" determination for their swaps transactions. For example, under our recommended definition, a non-U.S. fund that fits within the definition of U.S. person and its counterparties would understand that any swaps transactions entered into would be subject to CEA requirements as required by the CFTC. If, however, the determination of a "U.S. person" could evolve over time because of changes in the investor base that were beyond the control of a fund or its manager/operator, the counterparties would have to tackle the difficult issues of how swaps that were entered into before those changes would now have to comply with CEA requirements.

Second, our suggested alternative definition would look to whether the commodity pool, pooled account, or collective investment vehicle is attempting to target the U.S. market or U.S. investors and should appropriately be subject to U.S. laws. By focusing on the directed activities of the fund and its manager/operator, and not activities that are beyond the control of the fund or its fund manager/operator, we believe the CFTC could readily determine those funds that have a significant connection to the United States or to U.S. commerce. The definition would exclude, however, non-

[16] *See supra* note 7.

U.S. retail funds because they have little U.S. nexus and do not present risks to the U.S. markets or U.S. investors.[17]

For the reasons discussed above, it is important that the definition focus on to whom the fund is offered, and not require that it also be publicly traded, as many non-U.S. retail funds are publicly offered but not publicly traded. We believe this refinement is fully consistent with the CFTC's intention to "capture collective investment vehicles that are created for the purpose of pooling assets from U.S. investors and channeling these assets to trade or invest in line with the objectives of the U.S. investors, regardless of the place of the vehicle's organization or incorporation."[18] The Commission appears to have intended to exclude funds not targeting U.S. persons from the definition of "U.S. person," but limiting the scope of funds to those that are "publicly-traded" would not achieve completely that goal.[19]

Substituted Compliance and Grandfathering

Substituted compliance should be available to funds, and not limited to swap dealers and major swap participants. Non-U.S. retail funds are substantively regulated by the law of the jurisdiction in which they are organized, including derivatives regulation, and may also be subject to additional regulation in those jurisdictions in which they are authorized for sale. If the CFTC does not fully accept our suggested alternative definition of U.S. person for funds, we urge the CFTC to not define as a U.S. person any non-U.S. retail fund the transactions of which are subject to a comparable derivatives regulatory regime. For example, the derivatives activities of many European funds organized as UCITS, as well as funds sold in Asia that are organized as UCITS, are subject to EMIR. Permitting substituted

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[17] While some non-U.S. retail funds may, consistent with well-established positions of the staff of the Securities and Exchange Commission ("SEC"), make a limited private offering to U.S. investors, in addition to their public offering to non-U.S. investors, this limited private offering does not increase the risk to U.S. investors or U.S. markets. The SEC staff permits such offerings to be made only to a very limited number of U.S. investors, or investors who are highly qualified, ameliorating investor protection concerns. *See* Goodwin, Procter & Hoar, SEC No-Action Letter (pub. avail. Feb. 28, 1997); Touche, Remnant & Company, SEC No-Action Letter (pub. avail. Aug. 27, 1984). Under the U.S. Investment Company Act, a foreign fund is prohibited from using any means of U.S interstate commerce to offer or sell its securities in connection with a public offering unless the SEC has issued an order permitting the foreign fund to register under the U.S. Investment Company Act, which orders are exceedingly rare. The SEC staff takes the position that a non-U.S. retail fund may, however, make a limited private offering of its shares in the United States to fewer than 100 beneficial owners resident in the United States or to highly sophisticated "qualified purchasers" (individuals must have more than $5 million in investments) in the United States at the same time the fund publicly offers its shares overseas to non-U.S. investors. The existence of a limited private offering in the United States does not increase the risk to U.S. markets because the non-U.S. retail fund remains subject to substantive regulation offshore, and the risks of the fund's transactions remain within the fund and do not migrate to the United States as a result of the private offering. Each fund is a separate pool of securities with its own assets, liabilities and shareholders, and the non-U.S. retail fund's U.S. adviser or promoter does not guarantee the fund's transactions.

[18] *See Further Proposed Guidance*, *supra* note 4, at 913.

[19] *See* February ICI Letter, *supra* note 6, at 3.

compliance for these funds would avoid overlapping and potentially conflicting regulation and many of the problems discussed above. We also recommend that non-U.S. retail funds be provided a one-year compliance period to seek to ensure that comparable derivatives regimes in applicable jurisdictions have time to develop.

We also request that, if the CFTC does not fully accept our suggested alternative definition of U.S. person for non-U.S. retail funds, it permit existing non-U.S. retail funds that are managed by asset managers in the United States and that are publicly offered only to non-U.S. persons, to be grandfathered under the final cross-border guidance. As noted above, these non-U.S. funds can, consistent with U.S. law, publicly offer their shares to non-U.S. investors, but make a limited private offering to U.S. persons.[20] Those non-U.S. retail funds that made limited private offerings to U.S. persons did so in good faith under pre-existing offering restrictions, and may be unable to terminate existing investors that were permitted investors at the time of the sale. We believe that any other position regarding these funds by the CFTC would raise issues of fairness, and would be inconsistent with positions consistently taken over the years by the SEC and its staff.

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It is critical that the Commission take the time to work with other domestic and international regulators in order to develop workable solutions before adopting final cross-border guidance. As part of that process, we urge the Commission to develop a definition of U.S. person that takes into account the unique attributes of the regulated fund business, so that non-U.S. retail funds with U.S. asset managers do not suffer significant competitive disadvantages, despite their limited nexus to the U.S. markets. If you have any questions on our comment letter, please feel free to contact the undersigned, Sarah Bessin at 202-326-5835 or Jennifer Choi at 202-326-5876.

[20] *See supra* note 18.

Sincerely,

/s/ Karrie McMillan

/s/ Dan Waters

Karrie McMillan
General Counsel
Investment Company Institute
202-326-5815
kmcmillan@ici.org

Dan Waters
Managing Director
ICI Global
011-44-203-009-3101
dan.waters@ici.org

cc: The Honorable Gary Gensler
The Honorable Bart Chilton
The Honorable Scott D. O' Malia
The Honorable Jill E. Sommers
The Honorable Mark Wetjen

Gary Barnett, Director, Division of Swap Dealer and Intermediary Oversight
Jacqueline H. Mesa, Director, Office of International Affairs

The Honorable Mary Jo White
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
The Honorable Daniel M. Gallagher

John Ramsey, Acting Director, Division of Trading and Markets
Jim Burns, Deputy Director, Division of Trading and Markets